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Supreme Court of the United States

OCTOBER TERM, 1958.

No. 675.

IRVING D. FRIEDMAN,

Appellant,

against

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,

Appellees.

BRIEF FOR THE APPELLANT OPPOSING MOTION TO AFFIRM.

IRVING D. FRIEDMAN,
Appellant, Pro Se,
1501 Broadway,
New York 36, N. Y.

SOL FRIEDMAN,
1420 New York Avenue, N. W.,
Washington 5, D. C.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

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BRIEF FOR THE APPELLANT OPPOSING MOTION TO AFFIRM.

Appellant files this brief, in accordance with Rule 16, paragraph 3, of the Rules of this Court, in opposition to the motion of the appellees to affirm.

ARGUMENT.

POINT I.

There is no authority in law for the Commission's action which forces appellant to accept 26 years' rent as full payment of an obligation of the tenant, Illinois Central Railroad Company, to pay 323 years' rent.

The error made below can be found in the opinion of the District Court, where the Court quoted, with approval, the following part of the Commission's Report (Jurisdictional Statement, p. 23):

> "Upon consideration of all the evidence we are of the opinion and find that the fair values of the considered stocks do not exceed amounts which would be produced by capitalizing the respective dividends at a rate between 4.25 and 4.50 per cent. Capitalizing the dividends at the lower of these rates would produce $141.18 per share for the Alabama stock and $117.65 per share for the Vicksburg stock."

This is error because there is no common law or statutory authority which gives the Commission the right to capitalize the rental income payable under a long term lease. The Commission's action, approved by the Court below, in capitalizing the present worth of the rental payable under a 323 year lease, stems entirely from an assumption of power which the Commission does not have. The Report of the Commission is predicated on the clearly erroneous conception that the Commission, under its broad power to approve mergers of railroads, has the power to capitalize the rental income payable by a railroad tenant under a lease. It can point to no statute or judicial decision to authorize a merger on such terms, which allow a long term lease to be commuted by payment of the capitalized value of the rental.

The statute under which the capitalization of rental income was done, is Section 5(2) of the Interstate Commerce Act. This statute does not authorize a leasehold liability to be capitalized. It authorizes a merger, subject to terms and conditions as the Commission shall find to be just and reasonable.

The other authority under which the Commission and the District Court assumed that it had the power to capitalize income payable under a long term lease, is the Commission's report in Delaware, L. & W. Co. Merger, 257 I. C. C. 91. That decision is not applicable here, because of

the facts and complications, peculiar to that case, which is demonstrated in Point III of this brief. *The Delaware Merger* case is not a judicial decision; and this Court said of such authority:

> "While the interpretation given a statute by those charged with its enforcement is entitled to considerable weight, it hardly is conclusive. United States *v.* Missouri Pacific R. Co., 278 U. S. 269, 280 (1929)." County of Marin *v.* United States, 356 U. S. 412.

By assuming this non-existent power to capitalize rental income payable under long term, non-cancellable leases, and applying it to appellant, the Commission and the District Court have confiscated appellant's contractual rights to all of the rentals he is entitled to receive. They by-passed the obligation of a tenant to pay rent for 323 years under 323 year leases, ignored the principle of law which requires merging corporations to be responsible for all liabilities existing at the time of the merger, and confiscated appellant's rights to guaranteed fixed dividends until the termination of the leases on July 1, 2282, by the unauthorized device of capitalizing rental income.

Appellant respectfully submits that a liability to pay rent cannot be capitalized. What can be capitalized is the earning power of a common stock. Appellant's security is not a common stock, which shares in the profits and losses of his company. Appellant's security is a guaranteed, leased line, fixed dividend stock, issued under a lease. The rental income from such a lease, which is applied exclusively to pay the fixed dividends on appellant's stock, cannot be capitalized.

The error the Commission and the District Court committed in capitalizing the rental income from the leases is clear from the result. They found $155 and $126.50 per

share as just and reasonable prices. At $6 and $5 a year per share, respectively, these prices amount to the rental for 26 years. It is not just and reasonable, as a matter of law, to allow an obligation for the payment of 323 years' rent to be discharged by the payment of 26 years' rent.

POINT II.

There is no authority in law for the Commission's action which refuses to find the actual value of a railroad corporation being absorbed in a merger.

Two railroads are being absorbed by merger into the Illinois Central Railroad Company. Yet the Commission refused to find out the actual value of these railroads. The Commission held that it didn't have to know the actual value of the railroads because they are encumbered by long term leases. The Commission stated that because the railroads were leased, there was no legal requirement for their evaluation.

This case presents the astonishing situation of the Commission giving its approval to the liquidation, by merger, of two solvent railroad corporations, without knowing anything at all about their actual value.

When appellant brought this to the attention of the District Court, that Court said the doctrine of administrative finality barred it, and appellant, from questioning the Commission's action. (Jurisdictional Statement, pp. 22 and 23.)

Appellant does not challenge the power of the Commission as the final authority on the valuation of a railroad. Nor does appellant dispute the rule of administrative finality by asking this Court to substitute its judgment for that of the Commission on railroad values. Appellant

agrees with the quotation of the District Court from *McLean Trucking Co.* v. *United States*, 321 U. S. 67, that a merger case is a complex task requiring the facilities, judgment, wisdom, knowledge and experience of the Commission.

In the cases where the Courts applied the doctrine of administrative finality to the orders of the Commission, the Commission had come to a conclusion on the valuation of railroads, which action the Courts would not upset. In this case, however, the Commission did nothing to evaluate the merging railroads, and came to no conclusion of their value.

What the Commission did was to value only the rental income from the leases, which it found to be $155 and $126.50 a share. *It never valued the railroads.* By its failure and refusal to find the actual values of the merging railroads, which is a fundamental requirement, the Commission did not carry out its function. It did not apply its facilities, judgment, wisdom, knowledge, and experience in the transportation industry to this case. Therefore its conclusion is not entitled to the benefit of the doctrine of administrative finality.

The "Alabama" and "Vicksburg" are two railroads which are earning money right now. Appellant is entitled to know, through the experience and advice of the Commission, what the earning power of each of these railroads is; and he is entitled to be paid for this earning power when it is taken away from him in a merger.

The doctrine of administrative finality requires that the findings of the Commission be adequate and supported by evidence. In this case there are no findings and no evidence of the values of the merging railroads. One of the members of the Commission did inquire of counsel for the Illinois Central of the basis for the prices fixed in these merger proceedings:

"Commissioner Mitchell: How did you arrive at what the fair value of this stock was?"

"Mr. Zoll: We arrived at it by taking the highest prices which Illinois Central had paid for A & V and V S & P stock in acquiring it."

The foregoing quotation is another astonishing point in this case, which shows that the Commission based the value of appellant's security on the highest price which Illinois Central felt like paying for it. The normal and legal standard of value is earning power, and the Commission never found out what it is.

Appellant did not ask the Commission and the District Court to find out what the earning power of his railroads would be in 2282 when the leases expire. (Jurisdictional Statement, p. 25.) Appellant did ask the Commission to find out what the earning power of his railroads are right now. Appellant is entitled, in liquidation of his rights in this merger proceeding, to the rentals required to be paid under the leases, and in addition, to the current worth of the current earning power of his companies.

POINT III.

The motion to affirm should be denied because there is no judicial decision on the question of the rights of leased line stockholders in a merger proceeding.

There is no judicial decision that appellant can find on the problem presented by this case. The only authority relied on by the Commission and the Court below is *Delaware, L. & W. R. Co. Merger*, 257 I. C. C. 91, decided in 1944, which, because of its factual complications, does not have general application to leased line stock. The Report

was never reviewed by a Court. Finally, any rulings by the Commission made in that case were rendered obsolete by the case of *Schwabacher* v. *United States*, 334 U. S. 182, decided in 1948.

In the *D. L. & W.* case, the leased line stockholders could vote for or against the merger. The Commission stated in that case:

> "Whether the stockholder wishes to avail himself of the offer of the Delaware Company is a matter for his personal decision." 257 I. C. C. 91, at 120.

In the case at bar, any vote of minority stockholders against the merger was a futility because the Illinois Central owned more than 90% of the leased line securities when it submitted the merger applications to the stockholders and the Commission for approval.

In the *D. L. & W.* case, the leased line stockholders who did not approve the merger, had the right to go into state courts to ask for the payment of their rental under the lease, for an appraisal of their stock, and for any other relief they believed they were entitled to. Appellant does not have such rights in the case at bar because this Court held in the *Schwabacher* case, 334 U. S. 182, that no rights given to security holders by state laws survived a merger after it was approved by the Interstate Commerce Commission.

In the *D. L. & W.* case the lease was in default. Payment of the rent to the leased line stockholders had been suspended and enjoined. There was also a serious income tax dispute in that the landlord, Delaware, L. & W. R. Co., claimed that the corporation income tax payable on the rental payments, amounting to 40% thereof, should be deducted from the rent paid to the leased line stockholders.

That case is an individual one which does not clarify the legal rights of other leased line stockholders.

Decisions and Reports of the Commission are in conflict with each other, and in conflict with the case on appeal here.

In *Illinois Central Railroad Company Purchase,* I. C. C. Finance Docket No. 17288, decided May 23, 1951, not officially reported, which involved the merger of the properties of the leased Chicago, St. Louis & New Orleans Company into the Illinois Central Railroad Company, the Commission did not void the lease between the two companies, but held:

> "The payment of $4 a share on the leased-line stock certificates, which are not surrendered as a result of this proposal, will be continued, but upon consummation of the transaction all the capital stock of the New Orleans Company will be redeemed and cancelled."

and

> "Nevertheless, if leased-line certificates remain outstanding after the termination of the trust, the applicant will continue to redeem at par value any and all of such certificates that may be surrendered; and until they are redeemed, will continue the $4 annual payment mentioned, as previously stated."

In *Southern Railway Co. Purchase,* I. C. C. Finance Docket No. 16167, 275 I. C. C. 724 (1950), which involved the 50 year lease of the Richmond and Mecklenburg Railroad Company to the Southern Railway Company, the Commission held that the actual earning power of the leased line company was the primary consideration in a merger of the leased line into the Southern.

This ruling in the *Southern Railway Purchase* case that the actual earning power of a leased line company is the primary consideration in a merger, conflicts with the rule in the case at bar, in which the Commission holds that the

actual earnings of a leased company, involved in a merger, must not even be considered.

The *Delaware, L. & W.* case, 257 I. C. C. 91, on which the Commission and the District Court relied in coming to the conclusion that the actual earnings of a leased line company are irrelevant in a merger of such a company, contains the following vague and indefinite language:

> "The earnings from the operation of the property of the New York company, which as stated have not been segregated from those of the system, are not of controlling importance here."

In stating that they are not of controlling importance, the Commission, by inference, means they do have some importance. How much importance "not of controlling importance" means, is left undecided by the Commission.

Because of the lack of judicial authority, and the conflict and vagueness of the reports of the Interstate Commerce Commission, this Court should hear and determine this case. The rights of leased line stockholders should be clarified by a decision of the highest court.

Appellant's Answers to the Other Points Raised in the Motion to Affirm.

1. Appellees point out in a footnote on page 3 of their Motion to Affirm, that appellant owns about one per cent of Alabama stock, and one-half per cent of Vicksburg stock.

The District Court pointed out in a footnote to its opinion, which is on page 19 of the Jurisdictional Statement, that "at the time of the order under attack plaintiff owned about one per cent of Alabama stock and one-half per cent of Vicksburg stock."

This is an unfair and irrelevant factor. It has nothing to do with the merits of appellant's case. It can only have been inserted in the opinion of the Court and in the Motion to Affirm to prejudice appellant personally, by asking this Court to infer that appellant is a nuisance minority.

If a legal wrong has been done to appellant, he has the standing to ask this Court to redress such wrong. Appellant is entitled to justice, even though he is a small stockholder.

In *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, this Court found that a plan of reorganization, which had been overwhelmingly approved by the security holders, 92.81% of the bondholders, 99.75% of the Class A stockholders, and 90% of the Class B stockholders having voted in favor of it, was not fair and equitable. The only one who objected to the plan was a bondholder owning $18,500 par value of a large bond issue which amounted to $3,807,071. This Court held that such bondholder, who owned only ½ of 1%, was right in his contention that the proposed plan was not fair and equitable.

This Court held that where a plan is not fair and equitable, it cannot and should not be approved, no matter how many security holders consent to it:

> "Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one."
>
> *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106.

2. Appellees allege that appellant has no rights in the leases between the Alabama and the Vicksburg companies, as landlords, and the Illinois Central, as tenant.

This contention is without merit. Reference to the leases are endorsed on appellant's certificates. Such endorse-

ments, and the leases, state that the lessee has covenanted to pay a sum equal to 6% of the par value of the Alabama stock, (5% on the Vicksburg stock) in semi-annual payments of 3% on each April 1 and October 1, until July 1, 2282. The complete endorsement is in the footnote numbered 4 of the District Court's opinion on pages 21 and 22 of the Jurisdictional Statement.

This clear language gives to the appellant and every other stockholder of Alabama and Vicksburg, a vested interest in the leases, to the extent of the shares he owns. Such vested interest in the leases cannot be impaired or reduced by a merger. Contrary to the opinion of the District Court, and the argument of the appellees, the Illinois Central has guaranteed the rental payments on each stock certificate to each holder of the Alabama and the Vicksburg stock.

3. The appellees' statement on page 5 of its Motion to Affirm, that Article NINE, Section 2, of each lease provides for the cessation of rental payments upon the merger of the lessor into the lessee, is inaccurate and false.

Article NINE, Section 2 of the leases is quoted in the footnote on page 21 of the Jurisdictional Statement. It DOES NOT, in exact words or by inference, provide for the cessation of rental payments upon the merger of the lessor into the lessee. It does authorize such a merger, but it does not provide for the slightest diminution of any rental payments.

Like every other merger, a merger of the lessor into the lessee can only be made on terms that are just and reasonable. This requires that the Illinois Central redeem its obligations under the lease by paying all of the rent it owes thereunder to the maturity of the leases. After it

does that, it can apply to merge. It can't merge while it still owes rent for 323 years under a 323 year lease.

4. Appellees' allegation that appellant conceded that he is receiving full value for his stock, is likewise inaccurate and false.

Appellant has always contended before the Commission, the District Court, and this Court, that he is entitled to all of the rent payable under the 323 year leases, which amounts to $1942.50 on each share of Alabama stock and to $1618.75 on each share of Vicksburg stock. In addition, appellant has always contended that he is entitled to be paid the value of his stock, based on the actual value of the merging railroads.

Now, the appellees claim, by reference to a colloquy between appellant and the District Court, that appellant conceded he is receiving full value for his stock by the merger terms, which were approved by the Commission, of $155 and $126.50 per share for Alabama and for Vicksburg stock, respectively.

The statement appellant made to the Court, which is on page 7 of the Motion, is:

> "Yes, I agree with them that that is what its present worth is."

This statement was made in response to the Court's remark that

> "Its present worth would be discounted, I suppose."

No concession was made by appellant that the prices of $155 and $126.50 were fair. The District Court, with whom the colloquy took place, never understood that appellant was conceding that such prices were just and reasonable.

Appellant does agree that if the rental income payable

over the term of the lease is discounted, that the present worth of such discounted future rental payments is $155 and $126.50 per share, but appellant told the Court in the same colloquy:

> "Another reason this merger is contrary to law is that you can't reduce obligations and liabilities by merging. The Illinois Central owes me a contract to pay me $6 a year and $5 a year for 325 years. They have got to owe me the same contract after the merger that they owed me before the merger. * * *"
>
> * * * * * *
>
> "I have been damaged or injured because they have no right to pay me off at what it is worth. In a merger you have to pay or assume liabilities. You can't pay what they are worth."
>
> "I say it is absolutely irrelevant what it is worth. This can be worth $50 or $5,000; they have no right under the law to pay me what it is worth. They have got to pay me what it amounts to. This lease is an obligation that the Illinois Central must first redeem and pay off in full. After the lease is redeemed and terminated, then they can apply to merge."
>
> "But while they owe me the lease and this contract for the payment of fixed dividend for 325 years, that is a legal impediment to a merger."

Appellant contends that neither the Commission nor the Courts have any legal right to discount the future rental payments required to be made by Illinois Central, and to force appellant to take the present worth of any such discounted rental payments. No statute and no legal authority gives the Illinois Central the right to discount the rental payable over the term of the leases. On the contrary, it must pay the full amount of such rental.

Through all the proceedings in the Interstate Commerce Commission, the District Court, and in this Court, appellant has appropriately objected that the proposed mergers were, and still are, not just and reasonable.

Conclusion.

The questions on which this case depends are substantial, and are of general interest to railroads with leased line securities outstanding, and to the holders of such leased line securities.

Although it is not in the record, appellant asks leave to state to this Court that because of the economic pressure of lower gross revenues, and higher operating costs, railroad officials are considering mergers now more than at any time in the past 25 years. Major merger studies under way involve 18 railroads, representing over 23% of the Class I rail mileage in the United States. Some of the railroad mergers now being studied, are:

The Norfolk & Western Railway with the Virginian Railway.

The Atlantic Coast Line Railroad with the Seaboard Air Line Railroad.

The New York, New Haven & Hartford, the Boston & Maine, the Maine Central, the Bangor & Aroostock, and the Rutland Railway.

The Erie Railroad, the Delaware & Hudson Railroad, and the Delaware, Lackawanna & Western Railroad.

The Great Northern, the Northern Pacific, and the Chicago, Burlington & Quincy railroads.

The Minneapolis, St. Paul, Sault Ste. Marie, the Wisconsin Central Railroad and the Duluth, South Shore & Atlantic Railroad.

In addition, the Presidents of the New York Central Railroad and Pennsylvania Railroad have said their roads are still interested in mergers, even though discussions between the two have ended.

Most of these railroads have leased line securities, with fixed guaranteed dividend stocks, outstanding. If any of these merger studies develop into a reality, the problem of the rights of the leased line stockholders involved, will inevitably follow.

There is hardly any law in this field. The decisions and reports of the Interstate Commerce Commission are conflicting.

It is respectfully submitted that because this case is the first of its kind, this Court should hear it, so that the law will be established and clarified on the rights of leased line stockholders in mergers.

February 24, 1959.

Respectfully submitted,

IRVING D. FRIEDMAN,
Appellant, *Pro Se*,
1501 Broadway,
New York 36, N. Y.

SOL FRIEDMAN,
1420 New York Avenue, N.W.,
Washington 5, D. C.